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IN THE

Supreme Court of the United States

October Term, 1959

No. ~~[illegible]~~ 27

ROBERT LAWRENCE COMPANY, INC.,

Petitioner,

—against—

DEVONSHIRE FABRICS, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

October Term, 1959

No. 659

ROBERT LAWRENCE COMPANY, INC.,

Petitioner.

—against—

DEVONSHIRE FABRICS, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

Opinions Below

The opinion of the United States District Court for the Southern District of New York is unreported but is printed in the record on appeal to the Court of Appeals for the Second Circuit (R. 48a). The opinion of the Court of Appeals is reported at 271 F. 2d 402, and is printed in the appendix to the petition (A. 17-37).

Jurisdiction

The judgment of the Court of Appeals was entered on October 28, 1959, and made a judgment of the District Court by an order of that court entered on December 4,

1959. The petition for a writ of certiorari was filed January 26, 1960. The jurisdiction of this Court is invo under U. S. C. §1254(1).

Questions Presented

1. Whether in a diversity case the validity and in pretation of a provision, in a contract of sale and purch evidencing a transaction involving commerce, to settle arbitration a controversy arising out of such contrac governed by the Federal Arbitration Act or by state la

2. Did the Court of Appeals improperly find with any basis in the evidence adduced that the arbitration p vision in the contract of sale and purchase between par was separable from such contract?

3. Did the Court of Appeals improperly find that arbitration provision in such contract embraced a clain fraud in the inducement of the contract, when it refer to arbitration "any complaint, controversy, or ques which may arise with respect to this contract"?

4. Assuming *arguendo* that the validity and interp tation of the arbitration provision in a contract involv commerce is governed by state law and not by the Fede Arbitration Act in a diversity case, is the decision of Court of Appeals sustainable under the applicable s law?

Statute Involved

The statute involved is the Federal Arbitration 61 Stat. 669, 9 U. S. C. §1 *et seq.*

Statement of the Case

On August 4, 1955, petitioner Robert Lawrence Company, Inc. (Lawrence), a Massachusetts corporation, placed an order with respondent, Devonshire Fabrics, Inc. (Devonshire), a New York corporation, for certain fabric. Upon receipt of the order Devonshire issued a confirmation which differed in several material respects from the written and printed terms of the order.

Although Lawrence's petition to this Court assumes that its order, rather than Devonshire's confirmation, constituted the contract of purchase, one of the issues raised in the courts below was which paper, the order or the confirmation, constituted the contract between the parties. Each of the documents, however, contained an arbitration provision which provided that "[A]ny complaint, controversy or question which may arise with respect to this contract that cannot be settled by the parties thereto, shall be referred to arbitration."

Shipping instructions for delivery of the fabric were to have been issued by Lawrence by October 1, 1955. Nevertheless, Lawrence notified Devonshire on October 31, 1955 that because of a change of plans it would not need the fabric until the following year. Lawrence called for shipment of the goods from New York, and accepted delivery in Massachusetts in June, 1956, paying for them in full in July, 1956. Both the order and confirmation provided as a condition of the sale that "[M]erchandise shall not be returned nor allowance made after 15 days from receipt, nor after goods are sponged, cut or otherwise processed" (R. 18a, 24a).

On December 13, 1956 an attorney representing Lawrence sent Devonshire a lawyer's letter claiming that the fabric was patently defective. The claim was rejected by Devonshire.

Lawrence then commenced this action for damages alleging that fraudulent misrepresentations by Devonshire as to the quality of the goods induced it to enter into the contract of purchase.

In its answer, Devonshire denied the material allegations of the complaint and pleaded as affirmative defenses the arbitration clauses contained in the order and confirmation forms. Devonshire then moved in the District Court for summary judgment, and, in the alternative, under Section 3 of the Federal Arbitration Act, to stay the action until arbitration was had in accordance with the arbitration agreement between the parties.

The District Court denied both motions, finding that there was a substantial dispute as to the claim of fraud (R. 48a-49a). The decision failed to distinguish the contract of purchase from the agreement to arbitrate.

Upon appeal of the order denying a stay, the Court of Appeals reversed and directed a stay of the action, holding that the agreement to arbitrate was separable from the contract of purchase; that the contract was one within the scope of Section 2 of the Federal Arbitration Act; and that by the terms of the arbitration agreement, the claim of fraud in the inducement of the contract of purchase was referable to arbitration.

Reasons for Denying the Writ

1. The Court of Appeals has correctly applied established principles of federal law to the facts of this case.

Lawrence claims that the Court of Appeals for the Second Circuit in its decision herein evolved a new and important concept of substantive federal law in the field of arbitration. Although it claims that the issue is one

which should be settled by this Court, Lawrence does not specifically contend that the holding is erroneous, merely asserting that it is "novel and unworkable."[1] The basis for the assertion is that it would apply federal law to some parts of a contract, and state law to others. History and experience demonstrate that the principle is neither novel nor unworkable. As Professors Hart and Wechsler so aptly said in their treatise *The Federal Courts and the Federal System* 435-436 (1953):

> "Federal law is generally interstitial in character. It rarely occupies a legal field completely, totally excluding all participation by the legal systems of the states . . . It builds upon legal relationships established by the states, altering or supplanting them only so far as necessary for the special purpose . . . [This point] explains why frequently in litigation federal law bears only partially upon the case."

Without exhausting the possibilities, Professor Moore demonstrates that the principle of applying federal law to part of a problem is workable by citing more than twenty-two federal statutes which establish federal rights applicable to some parts of a transaction or contract while leaving other portions subject to state law. 1 Moore, *Federal Practice*, 3731-3755 (1959).

Only recently this Court found in applying federal law to part of a problem that "it is not uncommon for federal courts to fashion federal law where federal rights are

[1] Petitioner also suggests that the decision in the court below conflicts with the decision of this Court in *Bernhardt* v. *Polygraphic Co. of America, Inc.*, 350 U. S. 198 (1956). This contention is based on a misunderstanding of the *Bernhardt* case where the contract did not involve commerce, and hence, the agreement for arbitration did not come within the scope of Section 2 of the Federal Arbitration Act (see Point 2, *infra*). The contract in this case did involve commerce and Lawrence does not contend otherwise.

concerned." *Textile Workers Union of America* v. *Lincoln Mills of Alabama*, 353 U. S. 448, 457 (1957).

Application of the Federal Arbitration Act to the arbitration provision in the contract of sale between the parties in this action is but one more example of an instance where federal courts are required to fashion federal law because federal rights are involved. The text of the Act clearly requires the application of federal law to a contract evidencing a transaction in interstate commerce, such as is present in this case. The legislative history shows that the text manifests a Congressional purpose to create substantive federal rights under the commerce and maritime clauses of the Constitution. H. R. Rep. No. 96, 68th Cong. 1st Sess. 1 (1924).

2. The decision of the Court of Appeals is not in conflict with any decision of this Court.

Lawrence contends that the decision of the court below is "contrary to the central principle that this Court regarded as dispositive of" the case of *Bernhardt* v. *Polygraphic Co. of America, Inc.*, 350 U. S. 198 (1955). The principle that Lawrence refers to is that the outcome of litigation might depend upon the courthouse where a suit is brought, the so-called "outcome test." *Erie R.R. Co.* v. *Tompkins*, 304 U. S. 64 (1938); *Guaranty Trust* v. *York*, 326 U. S. 99 (1945); *Angel* v. *Bullington*, 330 U. S. 183 (1947); *Cohn* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541 (1949). This test has no application to this case and is appropriate only in a diversity case such as *Bernhardt*, which did not involve questions of federal law.

3. The decision of the Court of Appeals can be sustained on an independent state ground.

The Court of Appeals thought that if New York law were applied to the problems of this case it would have been forced to arrive at a contrary conclusion (A. 34-35). This view was based on an erroneous interpretation of the decision of the New York Court of Appeals in *Matter of Wrap-Vertiser Corp. (Plotnick)*, 3 N. Y. 2d 17, 143 N. E. 2d 366 (1957). In deciding that the New York law differed from the federal law, the court below ignored decisions in the lower courts of New York subsequent to *Wrap-Vertiser* which came to the same conclusion as that reached by the Second Circuit under federal law. In *Matter of Pan American Trade Development Corporation (Bertsch)*, N. Y. L. J. August 21, 1957, page 3, col. 1 (Sup. Ct. N. Y. Co.), an action for fraud in the inducement of a contract was stayed, the opinion, *inter alia*, stating:

> "The Court is of the opinion that the intent of the parties and the language of the arbitration agreement is broad enough to allow questions with regard to prior dealings insofar as they are related to the contract, to be decided by arbitration (*Matter of Wrap-Vertiser Corp'n*, 3 N. Y. 2d 17, is not contrary)."

The question whether fraud in the inducement is arbitrable under New York Law was again squarely faced in *Matter of M. W. Kellogg Co. (Monsanto Chemical Co.)*, N. Y. L. J. April 1, 1959, page 12 (Sup. Ct. N. Y. Co.), the court ruling that "matters urged on both sides going to the merit or lack of the merit of the claim of fraudulent inducement are not passed upon, for those remain for the arbitration." The decision was unanimously affirmed by an intermediate appellate court, 192 N. Y. S. 2nd 869, — N. Y. 2nd — (1959); *Accord, Aaron Krumbein & Sons v. Wanda Silk Mills*, N. Y. L. J. April 4, 1955, page 6, col. 7 (Sup. Ct. N. Y. Co.); *Matter of Amerotron (Maxwell*

Shapiro Woolen Co.), 3 A. D. 2d 899, 166 N. Y. S. 2d 214, aff'd 4 N. Y. 2d 722 (1958).

Although the Court of Appeals was bound to follow these lower court cases (*Fidelity Union Trust Co* v. *Field*, 311 U. S. 169 (1940)), they are not mentioned in its opinion. Had they been followed, the question of whether state law or federal law controlled would not have arisen.

The Court of Appeals also failed to rule on Devonshire's contention that Lawrence had waived its right to disaffirm the contract of purchase. Because it bypassed this issue, that court was obliged to choose between federal law and state law. If the court below had found that Lawrence had waived its right to disaffirm, its decision would stand even on its view of state law.

4. The decision of the Court of Appeals is not in conflict with any decisions of other Circuits.

Petitioner contends that the decisions of the Sixth Circuit in *American Airlines, Inc.* v. *Louisville and Jefferson County Air Board*, 269 F. 2d 811 (1959) and of the Ninth Circuit in *Ross* v. *Twentieth Century-Fox Film Corporation*, 236 F. 2d 623 (1956) are in conflict with the decision of the Second Circuit in this case. An analysis of the cases relied upon, however, fails to sustain the contention that there is a conflict.

In the *American Airlines* case, the Sixth Circuit said:

> "The Federal arbitration statute . . . was enacted in exercise of the Congress' plenary power over interstate commerce. . . . Within the scope of the statute circumscribed by the Constitution, Federal law is of course paramount under the Supremacy Clause, and State law must give way." *Supra* at 815.

The court, however, found in that case that state and not federal law governed because the issue was "a ground that goes to the very formation of the contract to arbitrate . . . whether the covenant to submit to arbitration was *ultra vires* the Air Board's authority." *Id.* at 817. There is no inconsistency between this ruling and the finding of the court below that there exist no grounds at law or in equity for the revocation of the arbitration clause of the contract between Lawrence and Devonshire. Indeed, as the court stated, "there was no dispute on the point. Lawrence does not allege that the arbitration provision was induced by fraud. Nor could it do so with any show of reason as its own order contained this identical clause" (A. 32).

For an additional and important reason the *American Airlines* case, which was an action for a declaratory judgment, is not in conflict with the decision in this case. The Sixth Circuit there refrained from granting a motion to compel arbitration, while directing the District Court to retain jurisdiction, pending determination by the state court of unsettled problems of state law. The action was taken in the exercise of its sound discretion under the familiar rule of *Railroad Commission of Texas* v. *Pullman Co.*, 312 U. S. 496 (1949).

In *Ross* v. *Twentieth Century-Fox Film Corp.*, *supra*, the question decided under California law was whether the language used in a contract amounted to an agreement to arbitrate. In this case, Lawrence does not deny that there is an agreement to arbitrate in the contract of sale, but argues only that the agreement is unenforceable because of certain events alleged to have occurred in the making of the principal contract. In addition, the Ninth Circuit in the *Ross* case was mistaken in its belief that its decision was required by *Bernhardt*. The contract in the *Ross* case involved commerce; the *Bernhardt* contract did not.

There is also no merit in the contention that *Kentucky River Mills* v. *Jackson*, 206 F. 2d 111 (1953) is in conflict with the decision below. There the principal argument that a provision for arbitration was invalid under state law was answered by the court finding "that the contract between the parties evidenced a transaction involving interstate commerce, and, hence, the arbitration provision in the contract was rendered valid, and its enforceability was to be determined under the provisions of the United States Arbitration Act, 9 U. S. C. A. §1 et seq." The appellate court also upheld the district court's determination that there was no fraud in the inducement of the contract.

Lawrence further contends that *Reynolds Jamaica Mines, Ltd.* v. *La Societe Navale Caenaise*, 239 F. 2d 689 (4th Cir. 1956) and *McElwee-Courbis Construction Co.* v. *Rife*, 133 F. Supp. 790, 794 (M. D. Pa. 1955) are in apparent conflict with the Second Circuit decision. These cases are not only not in conflict but are basically in agreement and were so regarded by the court below. Neither *Kulukundis Shipping Co.* v. *Amtorg Trading Corp.*, 126 F. 2d 978 (2nd Cir. 1942) nor *Almacenes Fernandez, S.A.* v. *Golodetz*, 148 F. 2d 625 (2nd Cir. 1944) are inconsistent with this case. But even if they were, being decisions of the Second Circuit, such inconsistencies would be a cause of concern only to that court and not to this Court. See Harlan, J., *Manning the Dikes*, 13 Record of N. Y. C. B. A. 541, 551-553 (1958).

6. The Court of Appeals' holding that the arbitration provision constituted an agreement separate from the contract for the sale of goods, was based on substantial evidence and ought not to be reviewed.

Whether an arbitration agreement is separable from a contract of sale will turn in every case on the particular language used and, if the language is ambiguous, on the

surrounding circumstances. The court below reviewed the contract and the evidence and found that the arbitration provision in this case was separable. The finding was consistent with the scheme of the Federal Arbitration Act, and this Court has repeatedly held that it does not sit to review evidence. Similarly, there is no important public issue involved in the question whether the arbitration agreement between Devonshire and Lawrence was intended by them to cover a claim of fraud in the inducement of the contract of sale, since the finding that such a claim was covered was based upon the particular language used in the agreement to arbitrate.

CONCLUSION

The application for the Writ of Certiorari should be denied.

Respectfully submitted,

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